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Dept. Of Commerce & Insurance
Company Examinations

Report of Examination
of
The Monroe County Mutual Fire Insurance Company of
Madisonville, Tennessee

Harold E. Sloan, Secretary
442 Main Street
Madisonville, TN 37354

Examination made as of: December 31, 2003

Examiner in Charge: James T. Pearce, Examiner III

Examination commenced: April 19, 2004

Date of Report: August 20, 2004

Examined as of: December 31, 2003

Last Examination as of: December 31, 1998

Commissioner Paula A. Flowers
Department of Commerce and Insurance
State of Tennessee
Nashville, Tennessee 37243

Commissioner:

Pursuant to your instructions, I have made an examination and submit the following report of the conditions and affairs of the

Monroe County Mutual Fire Insurance Company

Madisonville, Tennessee

Officers

Title	Name	Address	Term Expires
President	John Thompson	Philadelphia, TN	February 2005
Vice President	Clarence Hawkins	Madisonville, TN	February 2007
Secretary & Treasurer	Harold E. Sloan	Tellico, TN	February 2005

Directors:

Name	Address	Term Expires
John Thompson, President	Philadelphia, TN	February 2005
Clarence Hawkins, Vice President	Madisonville, TN	February 2007
Harold E. Sloan, Secretary & Treasurer	Tellico, TN	February 2005
George W. Beaty	Tellico, TN	February 2007
Roger Raper	Madisonville, TN	February 2006
James S. Brown	Sweetwater, TN	February 2007
Michael Gray	Tellico, TN	February 2007
Marshall Raper, Agent	Madisonville, TN	February 2006

Directors (cont.):

Name	Address	Term Expires
Lee Turpin, Audit Committee	Madisonville, TN	February 2006
Wayne Thomas	Madisonville, TN	February 2007
Dale Patterson, Agent / Audit Committee	Madisonville, TN	February 2006
Jerry Lay	Madisonville, TN	February 2005
Paul D. Mason, Audit Committee	Madisonville, TN	February 2006
Bill Shadden	Tellico, TN	February 2005

Compensation of officers, directors, appraisers, adjusters, et al:

The president received \$6,370 in 2003 or \$535 per month (\$535 per month for 11 months and \$485 for January), the vice president received \$5,045.00 in 2003 or \$425 per month (\$425 per month for 11 months and \$370 for January), the secretary / treasurer received \$30,276.52 in 2003. The directors received \$100 per called meeting. In 2003 the Company's office clerk received \$22,053.09.

Agents are paid \$2.50 per new policy written or endorsement adding new coverage to an existing policy (\$1.50 per thousand from the Company and \$1.00 per thousand in the form of a policy fee from the policyholder). Agents are paid \$2.50 per \$1,000 for a renewal of an existing policy and the policies are issued for a 5-year term (\$2.50 per thousand from the Company).

Agent # 1 received \$30,626.66 (no claims adjustment expenses included) and Agent / Adjuster # 2 received \$38,593.33 and that included \$5,032.03 in claims adjustment expenses.

Agents are paid \$300 per month in travel expense and 15% of the commission and policy fee received is counted as travel by the Company.

Claims adjustment reimbursement amounts of \$15.00 per hour and \$0.40 per mile and \$100 a month were paid to the Company's agent solely responsible for adjusting claims.

Report of changes in the Constitution or By-Laws, policy forms, or other agreements during the period covered by this examination.

Changes to the Company's rate schedule, including new deductibles, were approved by the Company's Board of Directors on July 21, 2001 and implemented effective September 1, 2001. The Company changed policy rates of existing policies on the renewal date. The last policies to be revised have an August 2002 renewal date.

Starting in September 2001 the Company changed rates to \$5.00 per thousand for houses and contents totaling \$50,000 up to \$75,000. All other risks were assessed at \$6.00 per thousand except chickenhouses, trailers (single wide mobile homes or double wide mobile homes not underpinned by a masonry foundation), cabins and store buildings where the owners reside in them. Those are to be insured at a rate of \$12.00 per thousand.

The Company's new rate schedule for all new or renewal policies written are included in the work papers of this examination report. Copies of the minutes to the Board of Directors meeting at which the policy limits were changed are included in the work papers of this examination report.

If copies have not been filed with the Department of Commerce and Insurance, are they filed with the work papers of this report?

The changes to the rate schedule were not filed with the Department and are included in the Company's policy form. Copies of the minutes to the Board of Directors meeting at which the policy limits were changed are included in the work papers of this examination report.

Report on reinsurance assumed and / or ceded.

At no time during the history of the Company has the Company entered into any reinsurance agreements.

Appraisal and classification of risks taken.

Policies are typically written for the full value of the property insured subject to policy limits of \$75,000 per risk. The agent performs the appraisal on the property prior to the issuance of a policy during the application process. Property eligible to be insured includes dwellings and contents, church buildings, farm buildings and contents, hay in barns chicken houses, farm machinery, cattle and commercial type property where the owner resides.

Annual rate of assessment per \$1,000.00 for period covered:

Starting in September 2001 the Company changed rates to \$5.00 per thousand for houses and contents totaling \$50,000 up to \$75,000. All other risks were assessed at \$6.00 per thousand except chickenhouses, trailers (single wide mobile homes or double wide mobile homes not underpinned by a masonry foundation), cabins, store buildings where the owners reside in them and apartment buildings and / or contents that have three or more units within the same structure. Those are to be insured at a rate of \$12.00 per thousand.

See the Examination Workpapers for the Company's new rate schedule effective September, 2001, for all new or renewal policies written.

Rate of membership, policy and initial fees charged.

As of December 31, 2003, the Company had \$78,256,542 of total insurance in force. New policyholders are charged \$2.50 for each new policy written or endorsement adding new coverage to an existing policy. The Company charges a rewrite fee of \$20.00 if the policy has been canceled less than a year on the same risk. The rewrite fee of \$20.00 was paid to the agent. The agent turns over all premiums and fees collected and then is reimbursed by the Company.

Date of last assessment.

The Company makes advance assessments of its members on the premium due date annually.

Amount delinquent.

There have never been any delinquencies. The Company cancels policies if assessments are not paid within forty five (30) days after the end of the premium due date.

Did that assessment provide for all losses, expenses and other liabilities, including borrowed money?

No. In 2003 the Company received \$483,236.39 in premium assessments and policy fees (for new business only). In 2003 the Company disbursed \$585,614.55 or \$102,378.16 more than premium assessments and policy fees. However, the Company received \$122,612.33 interest income (savings and certificates of deposit) and \$4,225.53 in miscellaneous income as noted in Section II - Income of the Company's 2003 Annual Statement. Furthermore, the Examiners discovered the Company understated the total amount of income received in 2003 on its 2003 Annual Statement by \$14,345.54. The total amount of 2003 investment income per examination was \$136,957.87.

* See the Income Statement Error heading (below) under the **Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business:** section of this report.

Amount of money borrowed since date of last assessment.

The Company has not borrowed any money during the period of examination.

Exhibit of Risks

	<u>Number</u>	<u>Amount</u>
1. In force, December 31, 2002		\$73,771,630
2. New Business Written in 2003		12,047,212
3. Business Renewed in 2003		12,293,120
4. Total		\$98,111,962
5. Deduct those expired and marked off as terminated		<u>(19,855,420)</u>
6. In-force, December 31, 2003		\$78,256,542
7. Amount Re-insured		NONE
8. Net Amount In force, December 31, 2003		\$78,256,542

Financial Statement**Income**

Gross Membership Fees (New Business Only)	\$11,618.10	
Deduct Return Membership Fees	(NONE)	
Gross Assessments	\$490,343.57	
Deduct : Reinsurance	(0.00)	
Deduct : Return Assessments	<u>(7,107.18)</u>	
Net Assessments	\$483,236.39	
Interest Income	*122,612.33	
Miscellaneous Income (Rental Income Old Office)	<u>4,225.53</u>	
Total Income	\$621,692.35	
Ledger Assets, December 31, 2002	<u>\$4,232,441.30</u>	
Total Income and Balance		<u>\$4,868,479.19</u>

* See the Income Statement Error heading (below) under the **Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business:** section of this report.

Disbursements

Gross amount paid policyholders for losses	\$376,844.55
Deduct : Reinsurance	<u>(NONE)</u>
Net amount paid policyholders for losses	\$376,844.55
Expenses of adjustment and settlement of losses	5,032.03
Commission or brokerage, including membership fees	56,410.19
Salaries and compensation of officers, directors, & employees	58,094.86
Advertising, Printing and Stationery	2,278.33
Postage, telegrams, telephones and express	3,195.34
Legal Expenses	NONE
Furniture and Fixtures	NONE
Insurance department licenses and fees	SEE BELOW IN OTHER TAXES
All other licenses, fees and taxes	67,092.24
Office Building Disbursements	7,958.02
Miscellaneous Expenses	8,708.99
Total disbursements	<u>\$585,614.55</u>
Balance	<u>\$4,268,519.10</u>

Assets

Book Value of Real Estate	\$312,936.01
Cash in Company's office	\$2,320.07
Cash in banks (business checking)	\$53,238.02
Savings Accounts, Certificates of Deposit	** <u>\$3,900,025.00</u>
Total admitted assets (per Company)	** <u>\$4,268,519.10</u>

** See the Investments Held Without a Custody / Safekeeping Agreement and the Balance Sheet Error heading (below) under the **Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business:** section of this report.

Liabilities

Total Liabilities	<u>-0-</u>
Surplus over all liabilities	<u>\$4,268,519.10</u>
Total	<u>\$4,268,519.10</u>

Assets

Schedule of Bank Deposits:

<u>Name of Bank</u>	<u>Amount on Bank Statement</u>	<u>Amount of O/S Checks</u>	<u>Adj. Items</u>	<u>Balance</u>
FSG Bank, Commercial Checking	\$113,081.11	\$59,843.09	\$-0-	\$53,238.02

Schedule and description of all other assets, including real estate, mortgage loans, bonds, etc., and interest or rents due or accrued thereon:

Certificates of Deposit :

Tennessee State Bank of Pigeon Forge, TN	\$100,000.00
Community Trust Bank of Madisonville, TN	\$100,000.00
Capital One of Richmond, VA	\$100,000.00
Regions Bank	\$100,000.00
NBC Bank of Alcoa, Tennessee	\$100,000.00
AmSouth Bank of East Tennessee	\$100,000.00
First Volunteer Bank of Etowah, TN	\$100,000.00
First Volunteer Bank of Etowah, TN	\$50,000.00
Athens Federal Community Bank of Athens, TN	\$100,000.00
Citizens National Bank of Sevierville, TN	\$100,000.00
First Security Bank of Sweetwater, TN	\$100,000.00
First Tennessee Bank of Maryville, TN	\$100,000.00
First National Bank of Loudon County, TN	\$200,000.00
Bank of Hapoalim, New York *	*\$100,000.00
Suntrust Bank of East Tennessee	\$100,000.00
Peoples Bank of Polk County	\$100,000.00
Southeast Bank and Trust of Athens, TN	\$100,000.00
First Security Bank of Sweetwater, TN	\$100,000.00
Wachovia Bank of Knoxville, TN	\$200,000.00
Tennessee Bank (of Oak Ridge, TN)	\$200,000.00
AmSouth Bank of East Tennessee	\$100,000.00
Commercial Bank of Knoxville, TN	\$100,000.00
Union Planters Bank of Maryville, TN	\$100,000.00
BB&T of Athens, TN	\$100,000.00
Capital One of Richmond, VA *	*\$100,000.00

Schedule and description of all other assets, including real estate, mortgage loans, bonds, etc., and interest or rents due or accrued thereon:

Certificates of Deposit (continued):

Citizens National Bank of Sevierville, TN	\$100,000.00
Volunteer Federal Savings and Loan of Madisonville, TN	\$100,000.00
BB&T of Athens, TN	\$100,000.00
Commercial Bank of Knoxville, TN	\$100,000.00
Peoples Bank of Monroe County, TN	\$100,000.00
NBC Bank of Alcoa, Tennessee	\$100,000.00
Peoples Bank of Monroe County, TN	\$100,000.00
Citizens National Bank of Sevierville, TN	\$100,000.00
South East Bank & Trust of Athens, TN	\$100,000.00
Peoples Bank of Monroe County, TN	\$50,000.00
Foothills Federal Credit Union of Knoxville, TN	\$100,025.00
Benton Banking Company of Benton, TN	<u>\$100,000.00</u>

Total Certificates of Deposit \$3,900,025.00

* These two (2) Certificates of Deposit with a total Annual Statement value of \$200,000 held through AmSouth Investment Services, Inc. were not-admitted for purposes of this examination as of December 31, 2003.

* See the Investments Held Without a Custody / Safekeeping Agreement heading (below) under the **Comments on any apparent violations of the laws of the State of Tennessee** section of this report.

Money Market Mutual Funds:

AmSouth Prime Money Market Class A **	<u>\$17,266.42</u>
Total Money Market Mutual Funds	<u>\$17,266.42</u>

** The AmSouth Prime Money Market Class A Mutual Fund with a total market value of \$17,266.42 held through AmSouth Investment Services, Inc. was not-admitted for purposes of this examination as of December 31, 2003. The Company did not show a value for this investment on their 2003 Annual Statement.

** See the Investments Held Without a Custody / Safekeeping Agreement and the Balance Sheet Error heading (below) under the **Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business:** section of this report.

Assets pledged or hypothecated:

NONE

Comments on claims, borrowed money and other liabilities:

Claims appear to be paid promptly and to the satisfaction of the policyholders.

No money was borrowed during the period of examination.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business:

Investments Held Without a Custody / Safekeeping Agreement

The Company at year-end 2003 invested in securities directly through AmSouth Investment Services, Inc. without a custody / safekeeping agreement as required by Tennessee Code 56-3-112 and Regulation 0780-1-46 in order to protect the policyholders from loss. Furthermore, these securities were held by a broker / dealer, AmSouth Investment Services, Inc. Tenn. Code Ann. § 56-3-112 only allows insurance companies "to deposit or arrange for the deposit of securities which it may own in a clearing corporation as defined in Tenn. Code Ann. § 47-8-102, in Euroclear or in a federal reserve bank under book-entry system". AmSouth Investment Services, Inc. was not qualified to hold on deposit the Company's securities based upon Tenn. Code Ann. § 56-3-112.

The \$200,000 total value of these two (2) certificates of deposit shown on the Company's 2003 Annual Statement was non-admitted for examination purposes as of December 31, 2003. The \$200,000 value of the these two (2) certificates was a part of the \$3,953,263.02 "Cash in Banks" total noted on the Assets – IV Section of the 2003 Annual Statement.

Also, the Company had \$17,266.42 invested in AmSouth Prime Money Market Class A fund. The \$17,266.42 par / market value of this money market mutual fund would normally be non-admitted in accordance with Tennessee Code 56-3-112 and Tennessee Regulation 0780-1-46-.04. However, the Company failed to record this money market investment on the Assets – IV Section of their 2003 Annual Statement.

* See the Balance Sheet Error heading (below) under the **Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business:** section of this report.

The total Admitted Assets per examination was determined to be \$4,068,519.10 or \$200,000 less than the \$4,268,519.10 amount listed by the Company in the 2003 Annual Statement.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business (continued):

Balance Sheet Error (Assets)

The Company did not record their \$17,266.42 investment in AmSouth Prime Money Market Class A fund in the Assets Section – IV on their 2003 Annual Statement. The examiners received a signed, detailed listing of securities and a signed and completed Form A Custodian Affidavit from an authorized representative of AmSouth Investment Services, Inc. verifying the \$17,266.42 money market investment held through AmSouth Investment Services, Inc. as of December 31, 2003.

The \$17,266.42 par / market value of this money market mutual fund would normally be non-admitted in accordance with Tennessee Regulation 0780-1-46-.04 "Required Custodian Affidavits". However, the Company failed to record this money market investment on their 2003 Annual Statement.

* See the Investments Held Without a Custody / Safekeeping Agreement heading (above) under the **Comments on any apparent violations of the laws of the State of Tennessee** section of this report.

Income Statement Error

The Company did not record 2003 dividend and interest income received in its AmSouth Investment Services, Inc. account on its 2003 Annual Statement. The Company should have recorded the total receipt of \$14,345.54 dividend and interest income in the Income Section – II on their 2003 Annual Statement.

The Company received \$65.06 in dividend income from its investment in AmSouth Prime Money Market Class A fund in 2003. Also, the Company received \$14,280.48 interest income from its investment in two (2) certificates of deposit shown on the Company's 2003 Annual Statement. The \$200,000 value of the these two (2) certificates was a part of the \$3,953,263.02 "Cash in Banks" total noted on the Assets - IV Section of the 2003 Annual Statement.

Therefore, the Company understated the total amount of "Savings and C. D." income received in 2003 on its 2003 Annual Statement by \$14,345.54. The examiners concluded the total dividend and interest income amount on the Income Section – II of the Annual Statement as of December 31, 2003 was \$136,957.87 as compared to the \$122,612.33 total provided by the Company.

Furthermore, in like manner, the Company understated the total amount of income received in 2003 on its 2003 Annual Statement by \$14,345.54. The examiners concluded the total income amount on the Income Section – II of the Annual Statement as of December 31, 2003 was \$636,037.89 as compared to the \$621,692.35 total provided by the Company.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business (continued):

Schedule of Rates

Starting in September 2001 the Company changed rates to \$5.00 per thousand for houses and contents totaling \$50,000 up to \$75,000. All other risks were assessed at \$6.00 per thousand except chicken houses, trailers (single wide mobile homes or double wide mobile homes not underpinned by a masonry foundation), cabins, store buildings where the owners reside in them and apartment buildings and / or contents that have three or more units within the same structure. Those are to be insured at a rate of \$12.00 per thousand.

In 2003 the Company had a \$50 deductible per loss (aggregate of \$100 for all risks covered under each policy) for all policies. In February of 2004 the Company's Members and Directors approved a \$100 deductible (aggregate of \$200 for all risks covered under each policy) for all policies.

See the attachment to the Exam Report for the Company's new rate schedule and placement guide for all new or renewal policies written.

Policy Limits, Reinsurance and Retention Limits

Based on the Company's amount of total insurance in force, T.C.A. §56-22-106 sets the maximum amount of coverage the Company is permitted to write on any one risk or hazard subject to one fire or loss at the maximum amount of \$75,000.

Location of Books and Records

All of the Company's books and records were kept in its office building located at 442 Main Street in Madisonville, Tennessee, 37354.

There were no apparent violations of the Company's By-Laws.

There were no other apparent violations of the Statutes of the State of Tennessee during the period under examination.

Recommendations:

It is recommended that the Company implement the following measures of corrective action for purposes of complying with statutory requirements:

1. The Company in future annual statement filings with the State of Tennessee should disclose their investments held through their broker / dealer, AmSouth Investment Services, Inc. and without a custody / safekeeping agreement in violation of Tennessee Code 56-3-112 and Regulation 0780-1-46 as non-admitted assets and reduce surplus accordingly.

Furthermore, in order to disclose the aforementioned investments as admitted assets in future annual statement filings with the State of Tennessee the Company should establish a custodial agreement with a financial institution that complies with Tennessee Code 56-3-112 and Regulation 0780-1-46 in order to protect the policyholders from loss.

Subsequent Event: The Company on June 25, 2004 sold the two (2) certificates of deposit held directly through AmSouth Investment Services, Inc. without a custody / safekeeping agreement and received \$204,685.19 (\$202,000 principal and \$2,685.19 interest). The Company on June 29, 2004 invested the \$200,000 principal amount in two (2) \$100,000 certificates of deposit (# 1162 and 1163) held by American Trust Bank of East Tennessee.

Therefore, the Company as of June 26, 2004 was no longer in violation of Tenn. Code Ann. § 56-3-112 and Regulation 0780-1-46.

Conclusion

It was determined that, as of December 31, 2003, the Company had admitted assets of \$4,068,519.10 and liabilities, exclusive of capital, of \$0.00. Thus, there existed for the additional protection of the policyholders, the amount of \$4,068,519.10 in the form of unassigned funds (surplus).

It appears that the Company is being operated in the best interest of the policyholders.

The complete and courteous cooperation of Mr. Patrick Dalton, Office Clerk and Mr. Harold E. Sloan, Secretary / Treasurer, extended during the course of the examination is hereby acknowledged.

Respectfully submitted,

James T. Pearce, Jr.

James T. Pearce, Jr.
Insurance Examiner in Charge
State of Tennessee

Examination Affidavit:

The undersigned deposes and says that he has duly executed the attached examination report of The Monroe County Mutual Fire Insurance Company of Madisonville, Tennessee dated August 20, 2004 and made as of December 31, 2003, on behalf of the Tennessee Department of Commerce and Insurance. Deponent further says he is familiar with such instrument and the contents thereof, and that the facts therein set forth are true to the best of his knowledge, information and belief.

James T. Pearce, Jr.

James T. Pearce, Jr.
Insurance Examiner
State of Tennessee

County Davidson
State Tennessee

Subscribed and sworn to before me
this 23rd day of
August, 2004.

Helen M. Leroy
(Notary)